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No. 94-886

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

MICHAEL JACKSON, ET AL.,
Petitioners,

v.

CULINARY SCHOOL OF WASHINGTON, LTD., ET AL.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY TO BRIEF IN OPPOSITION

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INTRODUCTION

Far from supporting dismissal of the petition, the principal basis of the Solicitor General's opposition highlights the need for review by this Court. The Solicitor General asserts that the court of appeals directed dismissal of this declaratory judgment action because the rule of *Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941), applies only in actions where subject matter jurisdiction is based on diversity, unlike this case where jurisdiction is based on federal question and supplemental jurisdiction. This interpretation of the ruling below, however, only exacerbates the problems created by this decision because it suggests that the ruling not only affects declaratory judgment actions, but actions for injunctive relief and damages as well.

The government's other arguments for denying certiorari are also without merit. Contrary to the government's claim that this action is "exceptional," the issues presented here are typical of claims by participants in the student loan program and, for that matter, participants in any federal programs that rely on state law and involve parties from more than one jurisdiction. Moreover, as described in the petition and summarized below, the government's assertion that petitioners will have an adequate opportunity to raise their defenses is simply not correct, nor did the court of appeals even consider the adequacy of alternative remedies. In this case, and many other situations, the declaratory relief that the court of appeals held is foreclosed may be the *only* way to challenge claims by the government, or private parties (in this case, lenders and guarantee agencies) acting under federal authority.

ARGUMENT

1. Initially, we note that the Solicitor General's claim that the court of appeals "pretermitted" the choice of law inquiry by exercising its "equitable discretion" to deny declaratory relief, Opposition at 7, misstates what that court of appeals did. The court of appeals decided that declaratory relief must be denied on all claims arising under local law *because* it concluded that the choice of law rules of the forum in which a future coercive action would be brought should govern such claims. *See* A9, A15. The conclusion that the choice of law rules of the forum in which the court sits do *not* govern is the essential predicate for the court of appeals' ruling that declaratory relief is inappropriate.

The Solicitor General maintains that this ruling is not limited to declaratory judgments, and defends the decision below by arguing that *Klaxon* is inapplicable to *all* actions where jurisdiction is not based on diversity of citizenship. Opposition at 6. This explanation of the ruling, however, only magnifies its significance. Whether the ruling is based

on the premise that *Klaxon* does not apply to declaratory judgment actions, or on the premise that *Klaxon* does not apply where jurisdiction is not based on diversity, it warrants review by this Court.

Indeed, the Solicitor General's interpretation makes review by this Court more important because, under his view, *Klaxon* is inapplicable wherever state law issues must be decided by federal courts in nondiversity cases, regardless of whether the claim seeks declaratory relief, an injunction, or damages. The significance of this position is highlighted by the fact that 28 U.S.C. § 1367, enacted in 1990, gives the federal courts "supplemental jurisdiction" over claims arising under state law that is broader than the "pendent" and "ancillary" jurisdiction recognized in pre-1990 decisions. *See Finley v. United States*, 490 U.S. 545, 548-56 (1989). Moreover, Congress has restricted the ability of federal courts to decline to exercise jurisdiction over such claims on discretionary grounds. 28 U.S.C. § 1367(c).

The Solicitor General's position is also inconsistent with the statute and reasons underlying the rule announced in *Klaxon*. The relevant statute, the Rules of Decision Act, provides that, except where federal law applies, state law "shall be regarded as rules of decision in civil actions" in the federal courts, and this mandate does not depend on the basis for jurisdiction. 28 U.S.C. § 1652. Moreover, in *Klaxon* this Court held that federal courts must apply the choice of law rules of the forum in which they sit because any other result would "do violence to the principle of uniformity within a state." *Klaxon*, 313 U.S. at 496. This concern is equally applicable to claims presented to federal courts under supplemental jurisdiction. Under the Solicitor General's position, however, uniformity is shattered because different substantive law may govern claims presented in federal and state courts of the same state if the claim is presented to the federal court under supplemental jurisdiction. In addition, a federal court may apply different substantive law to the same

claim depending on whether it is brought under diversity or supplemental jurisdiction.

The Solicitor General correctly notes that this Court has never ruled on whether *Klaxon* only applies to diversity jurisdiction. But what the Solicitor General does not acknowledge is that every court of appeals that has addressed the issue (including the District of Columbia Circuit) has concluded that *Klaxon* applies to claims arising under pendent jurisdiction.[1]

Consequently, if *Klaxon* does not apply to the claims at issue here, there is no body of applicable choice of law rules. Federal courts have never articulated special choice of law rules for claims under federal question or supplemental jurisdiction because they have concluded that state choice of law rules control such claims, just as in diversity jurisdiction.[2] If the Solicitor General's position is correct, however, federal choice of law rules must be developed for state law issues in all nondiversity cases, regardless of the type of relief sought. Thus, the decision below, particularly as construed by the Solicitor General, represents a fundamental

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[1] *See McSurely v. McClennan*, 753 F.2d 88, 110 (D.C. Cir.), *cert denied*, 474 U.S. 1005 (1985); *In re Merritt Dredging Co.*, 839 F.2d 203, 205 (4th Cir. 1988); *Baltimore Orioles, Inc. v. Major League Baseball Players Assoc.*, 805 F.2d 663, 681 (7th Cir. 1986); *Bi-Rite Enterprises, Inc. v. Bruce Miner Co., Inc.*, 757 F.2d 440, 442 (1st Cir. 1985); *Colgate Palmolive Co. v. S/S Dart Canada*, 724 F.2d 313, 316 (2d Cir. 1983), *cert denied*, 466 U.S. 963 (1984); *Harmsen v. Smith*, 693 F.2d 932, 946-47 (9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983); *System Operations, Inc. v. Scientific Games Development Corp.*, 555 F.2d 1131, 1136 (3d Cir. 1977).

[2] Of course, if a claim is governed purely by federal law, choice of law issues do not arise because there is no need to choose among the laws of different states. The choice of law issue arises only where (i) the claim arises under state law; or (ii) the claim arises under federal common law, but federal common law incorporates state law. Both types of claims are presented here. *See* A9 n.9.

departure from the prevailing law that warrants review by this Court.

2. The government's argument that petitioners' claim is "unique" and the decision below is "quite narrow," Opposition at 10-11, also does not withstand scrutiny. Petitioners' claims are typical of those of students who maintain that their loan is invalid or subject to defenses based on fraud, misrepresentation, failure to perform, or similar grounds. Such claims are governed by state law, unless state law is in "actual conflict" with federal law.[3] Moreover, because the student loan program allowed (indeed, encouraged) lenders and guarantee agencies to finance loans for schools and students in other states, choice of law issues will often arise over such claims.[4] Thus, petitioners are in the same position as thousands of other borrowers.

More importantly, the issues presented here are not unique to the student loan program. In most areas, federal legislation operates against a backdrop of contractual, property and other legal relationships defined by state law, and state law governs those relationships unless it is in direct conflict with federal law. *See Wallis v. American Petroleum*

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[3] Both the Department of Education and the courts, including the court of appeals here, agree that state law governs the enforceability of student loans, unless the state standards are in actual conflict with federal law. *See* 57 Fed. Reg. 60379, 60304 (1992) (state law defenses apply unless state laws would frustrate accomplishment of federal objectives); A13-15, A9 n.9 (state standards govern unless in actual conflict with federal law); *Tipton v. Secretary of Education*, 768 F. Supp. 540, 551-65 (S.D.W.Va. 1991) (same).

[4] *Abuses in Federal Student Aid Programs*, 102d Cong., 1st Sess., S. Rep. 102-58, 21-22 (1991) (student loans program operated as a mail order business in which lender can be from any state).

Corp., 384 U.S. 63, 68 (1966).[5] As a result, federal courts are frequently presented with disputes that are governed by state law, require the resolution of choice of law questions, and raise preemption issues. *See, e.g. Wallis*, 384 U.S. at 68-69 (lower court applied *Klaxon* to resolve choice of law question in contractual dispute over federal mineral lease). Such claims present the same state law, choice of law, and preemption issues that the court of appeals found preclude declaratory relief here. In short, the *Klaxon* questions presented by this petition do not depend on whether the claim arises in the student loan program; these questions arise whenever a federal court must adjudicate issues governed by state law and, to do so, must resolve preliminary choice of law questions.

The government also errs in asserting that the choice of law issues presented here are "exceptionally complicated." Opposition at 12. The loan contracts were executed by the petitioners in the District of Columbia to purchase educational services in the District. A6, A15. Only one defendant (Crestar) argued on appeal that choice of law considerations precluded applying the District of Columbia's consumer protection statute to these loans. This choice of law issue is typical of those that arise in any contract action involving parties in different states. If anything, the choice of law issues are relatively easy in this case because of the strong connection between the transactions and the District of Columbia.

Finally, the government's argument that denying declaratory relief was appropriate because it is not certain whether D.C. law would apply in a future coercive action, Opposition at 12, is circular. This argument assumes that the court of appeals correctly concluded that the choice of

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[5] *See also United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728-30 (1979); *Miree v. DeKalb County*, 433 U.S. 25, 31-34 (1977); *United States v. Yazell*, 382 U.S. 341, 351-352 (1966); *Bank of America Nat. Trust & Sav. Assn. v. Parnell*, 352 U.S. 29, 33 (1956).

law rules of the forum of a future coercive action should govern. If, however, the choice of law rules of the forum in which the declaratory action was brought apply, and petitioners obtain a declaratory judgment that their loans are unenforceable, this judgment would preclude any future coercive action under ordinary *res judicata* principles. The ruling below should be overturned by this Court precisely because it requires that declaratory relief be denied in order to allow the defendant to select the forum and applicable choice of law rules—a conclusion that is in conflict with the traditional principle that plaintiffs are entitled to the benefit of the laws of the forum they select. *Ferens v. John Deere Co.*, 494 U.S. 516 (1990); *Van Dusen v. Barrack*, 376 U.S. 612, 629-40 (1964).

3. Review by this Court is also warranted because the ruling below is likely to deny petitioners any opportunity to litigate their claims. The government's bald assertion that "[p]etitioners will have a fully adequate opportunity to litigate their claims and defenses" in future wage garnishments or tax refund intercepts proceedings, Opposition at 12, is erroneous for two reasons.

First, the government ignores the fact that the Higher Education Act imposes penalties on borrowers in default, even when there has been *no* wage garnishment, tax refund intercept, or other administrative or judicial collection action. Borrowers who default—including those who fail to repay because they believe that they have valid defenses—are automatically disqualified from any federal educational assistance, and the Secretary requires that lenders and guarantee agencies issue adverse credit reports on the borrowers to national credit bureaus. *See* Petition at 5. By foreclosing declaratory and injunctive relief to such borrowers, the ruling below leaves them without *any* means to contest these penalties.

Second, even if the Secretary or guarantee agencies pursue collection through a wage garnishment or tax refund

intercept, the borrower's only remedy is to request that the Secretary or guarantee agency review the enforceability of the debt. *See* 34 C.F.R. §§ 30.33, 682.410(b)(10) (1994). These reviews hardly provide an adequate opportunity to litigate the issues, let alone a substitute for a declaratory action. *See* Petition at 20-21. Moreover, the only mechanism for borrowers to challenge the Secretary's or the guarantee agencies' determination that the debt is enforceable is through an action for declaratory or injunctive relief—the very type of action foreclosed by the ruling below. *See id.* at 21.

The government's claim that the court of appeals determined that wage garnishment or tax refund intercepts reviews "would be a 'better' mechanism for adjudicating" petitioners' claims because choice of law issues "can more easily be resolved" in an individual proceeding, Opposition at 14, plainly misstates the record. The decision below shows that the court of appeals never examined whether such reviews provided an adequate (much less "better") mechanism for resolving petitioners' claims, despite prior decisions of this Court indicating the importance of making this inquiry before denying declaratory relief. *Brillhart v. Excess Ins. Co. of America*, 316 U.S. 491, 495 (1942). Moreover, choice of law issues are not more easily resolved in an individual tax refund intercept or garnishment review because in such reviews there is no "forum state" to provide the relevant choice of law rules. In addition, the minimal procedures provided in these reviews are clearly ill-suited to litigating the choice of law and preemption issues that the court of appeals declined to adjudicate.

Thus, the decision below warrants review because it does not simply require that petitioners' claims be presented to another court at another time. At worst, the ruling denies petitioners *any* opportunity to challenge the enforceability of the loans; at best, it relegates petitioners to raising their claims in garnishment and tax refund intercept reviews that

plainly do not provide an adequate mechanism for litigating these issues.

4. The government's statement that changes in the law make review unwarranted is disingenuous. The government states that 20 U.S.C. § 1087(c)(1)'s mandate that the Secretary discharge certain student loans potentially provides relief for "many of petitioners in the instant case." Opposition at 15. However, in the nearly three years that this provision has been in effect, the Secretary has yet to discharge the loans of *any* of the 58 students involved in this case. Moreover, the Secretary has adopted regulations that interpret this statute as being inapplicable to the extent that a student's loan is, as petitioners maintain here, subject to defenses that make it unenforceable. 34 C.F.R. § 682.402(a)(3) (1994); 59 Fed. Reg. 22462, 22464 (1994).

The government's claim that the 1992 amendments eliminated the issues presented here is also misplaced. To the contrary, in 1992 Congress considered and rejected legislation that would have eliminated these issues by preempting state-law based defenses because Congress believed that the issues that the court of appeals declined to resolve here should be resolved on a case-by-case basis in the courts. *See* A14 n.13; H.R. CONF. REPT. NO. 630, 102d Cong., 2d Sess. 508 (1992), *reprinted in* 1992 U.S.C.C.A.N. 334, 623. Moreover, by 1992, there were already approximately $ 19 billion in outstanding guaranteed student loans, many of them from borrowers attending proprietary schools.[6] There is no statute of limitation on collection of these loans. 20 U.S.C. § 1091a(a)(2). Consequently, the issues that the court of appeals held cannot be resolved in a declaratory judgment will continue to affect the

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[6] U.S. Dept. of Education, FY 1992 LOAN PROGRAMS DATA BOOK at 69 (1994). The default rates for proprietary school borrowers are between 50-60%, while the rates for borrowers from other types of schools ranges from 13-31%. *Id.* at 66.

loans of millions of students. The court of appeals' ruling, however, leaves petitioners and similarly situated students with no means to have the merits of their claims decided.

5. Finally, in the ruling below, the court of appeals concluded as a threshold matter that the district court's decision to entertain, rather than dismiss, petitioners' action for declaratory relief is subject to *de novo* review, and reversed the district court's decision to issue a declaratory judgment. A10-12. In *Wilton v. Seven Falls Co.*, No. 94-562, *cert. granted*, 115 S. Ct. 571 (Nov. 28, 1994), *argument scheduled for March 27, 1995*, this Court will decide whether such district court decisions should be reviewed *de novo* or for abuse of discretion. Consequently, at a minimum, this Court should hold this case pending the outcome of *Wilton* and, if it decides in *Wilton* that *de novo* review is not appropriate, the ruling below should be vacated and remanded for further proceedings in accordance with that decision.

Respectfully submitted,

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